DOCKET FILE COPY ORIGINAL
RECEIVED
MAR 20 1998
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Applications of WorldCom, Inc. and	)	
MCI Communications Corporation for	)	CC Docket No. 97-211
Transfer of Control of	)	
MCI Communications Corporation	)	
to WorldCom, Inc.	)	

Reply Comments of the COMMUNICATIONS WORKERS OF AMERICA

George Kohl
Debbie Goldman

501 Third Street N.W.
Washington, D.C. 20001
202-434-1187 (phone)
202-434-1201 (fax)
debbie@cwa-union.org

Dated: March 20, 1998

No. of Copies rec'd 0+10
List A B C D E

I. Introduction and Summary

MCI and WorldCom fail to demonstrate to the Commission that their proposed merger is in the public interest. Therefore, based on the Commission's merger review standard as articulated in the Bell Atlantic/NYNEX Order, the Commission should deny the Applicants' merger request.

The Commission clearly stated in its Bell Atlantic/NYNEX Order that "the burden of proof is on the applicant" to demonstrate that a proposed merger is in the public interest.[1] The Commission also stated that "it is incumbent upon applicants to prove that, on balance, the merger will enhance and promote, rather than eliminate or retard, competition."[2] The Commission noted that it will judge a merger as pro-competitive only if the "harms to competition — i.e. enhancing market power...are outweighed by benefits that enhance competition."[3] The Commission further stated that "applicants carry the burden of showing that the proposed merger would not eliminate significant sources of ... competition."[4] And finally, the Commission concluded that "if applicants cannot carry this burden, the applications must be denied."[5]

---

[1] In the Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, *Memorandum Opinion and Order*, File No. NSD-L-96-10 (Aug. 14, 1997), pp. 2 and 29 (hereinafter Bell Atlantic NYNEX Order).

[2] *Id.*, p. 3.

[3] *Id.*, p. 2.

[4] *Id.*, p. 3.

[5] *Id.*, p. 2.

WorldCom and MCI fail to prove that the merger is in the public interest. WorldCom and MCI fail to provide the Commission with facts, data, or studies to support their claim that the merger will enhance competition in the local exchange market. WorldCom and MCI fail to provide facts, data, or studies to support their claim that the merger will not harm competition in the Internet market. The failure to provide factual data on the Internet market is particularly problematic, given the "secretive commercial culture"[6] and paucity of publicly available data that characterizes the Internet market.

Absent more factual evidence, the Commission simply cannot evaluate the joint Applicants' claims. The Commission should request access to the Hart-Scott-Rodino documents submitted to the U.S. Department of Justice as part of its anti-trust merger review and should allow petitioners and commentators access to those documents under protective order. CWA also believes the Commission should open an investigation into the Internet market structure and that the Commission should not conclude its review of the proposed merger between WorldCom and MCI until completion of that broader investigation.

In contrast to the failure by WorldCom and MCI to prove their claims with factual evidence, the evidence that CWA[7] and other commentators have provided to the Commission demonstrates that

---

[6] Keefe, Jeff *Monopoly.com: Will the WorldCom-MCI Merger Tangle the Web?*, Washington, D.C.: Economic Policy Institute, uncorrected proofs, 1998, p. 4.

[7] Comments of the Communications Workers of America, *In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211, Jan. 5, 1998 (as amended Jan. 6, 1998), pp. 16-24 (hereinafter CWA Comments) and Reply Comments of the Communications Workers of America, *In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications*

the merger is not in the public interest. First, the merger will reduce actual competition in Internet, long distance, and international markets. In the Internet market, the merger will result in a dominant firm that will control more than 63 percent of the Internet backbone market, with the power through unilateral or concerted action to set the terms and price of interconnection to the Internet. Second, in local exchange and exchange access markets, the merger will reduce actual competition for by eliminating one current competitor. Even more significant, the merger will reduce potential competition for residential and small business customers due to MCI's retreat from this market as a direct result of the merger. Third, the merger will reduce employment growth in the telecommunications industry by an estimated 75,000 jobs, in addition to thousands of merger-related lay-offs of current workers. Fourth, the merger will likely result in higher rates paid by residential consumers, reduced investment, or both in the local exchange, as a result of accelerated access charge bypass.[8]

In these Reply Comments, we provide additional evidence of anti-competitive impacts on the local exchange market, the Internet market, and on job loss resulting from the merger.

Corporation to WorldCom, Inc., CC Docket No. 97-211, Jan. 26, 1998, pp. 12-14 (hereinafter CWA Reply Comments).

[8] We discuss this fourth point in CWA Comments, pp. 27-31, and CWA Reply Comments, pp. 15-16. Since we do not elaborate on this point in these Reply Comments, we briefly re-state the argument in this note. In the CWA Comments and CWA Reply Comments we point out that the Commission in its Access Reform Order determined that a gradual transition to cost-based access charges is necessary to enable incumbent local exchange carriers to recover costs incurred to build ubiquitous networks to meet Commission universal service goals. While MCI and WorldCom are correct to point out that the Telecommunications Act of 1996 and the Commission in its Access Reform Order anticipate transition to cost-based access charges, this does not refute our argument that accelerated access charge bypass beyond that envisioned by the Commission in its Access Reform Order will put pressure on incumbent LECs to push for local rate increases, reduced investment, or both to compensate for the revenue loss. Thus, the impact of the merger will be to undermine the 1996 Act's goals to reduce prices and stimulate deployment of advanced telecommunications services for all Americans.

II. The Merger Will Have an Anti-Competitive Effect in Local Exchange and Exchange Access Markets

WorldCom and MCI argue that a merged WorldCom/MCI will be the "strong and aggressive competitor" that will break the bottleneck in the local exchange market.[9] Yet, the Applicants fail to provide the Commission with copies of business plans, maps, and engineering and construction documents to prove their claim. Absent this documentation, the Applicants fail to meet the Bell Atlantic/NYNEX merger review standard to prove that the merger will enhance competition in the local exchange market.

Rather, as CWA noted in our Comments and Reply Comments,[10] the merger will have an anti-competitive impact in local exchange and exchange access markets in two ways: first, by reducing the number of facilities-based competitors in the local exchange by one; and second, by reducing potential competition in the local market for residential and small business customers.[11]

A. The Merger Will Reduce by One the Number of Competitors in the Local Exchange and Exchange Access Markets

[9] Joint Reply of WorldCom, Inc. and MCI Communications Corporation to Petitions to Deny and Comments, *In the Matter of Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211, Jan. 16, 1998, p. iv. (hereinafter Joint Reply of WorldCom and MCI).

[10] CWA Comments, pp. 16-24; CWA Reply Comments, pp. 12-14.

[11] The Commission identified the local exchange and exchange access market for residential customers and small businesses as a distinct product market and customer group for purposes of merger analysis. *See* Bell Atlantic/NYNEX Order, pp. 50 and 53, and CWA Comments, p. 17.

One of the goals of the 1996 Telecommunications Act was to break bottleneck monopoly control in the local loop by stimulating facilities-based competition. But as a result of the merger, the number of facilities-based competitors will be reduced by one.

MCI and WorldCom (through WorldCom's recently acquired MFS and Brooks Fiber subsidiaries) currently compete to serve business customers with their own facilities in at least 22 urban centers in 17 states. These urban centers are: San Francisco, Ca., Los Angeles, Ca., San Diego, Ca., New York, N.Y., Orlando, Fla., Tampa, Fla., Miami, Fla., Cleveland, Oh., Minneapolis, Mn., Denver, Co., Philadelphia, Pa., Pittsburgh, Pa., Boston, Ma., Newark, N.J., Detroit, Mi., Chicago, Il., Seattle, Wa., Phoenix, Az., Portland, Or., Atlanta, Ga., Baltimore, Md., and Hartford, Ct. (see Attachment).[12] *Prima facie* this merger will reduce competition in these cities.

WorldCom and MCI argue that the merger will not have an anti-competitive effect in these urban centers because there is no "overlap in the sense of duplicate or redundant facilities."[13] However, WorldCom and MCI fail to provide the Commission with maps and related documents that detail the actual location and the type of facilities in these urban centers. Therefore, the Commission is unable to verify Applicants' claim that there is no "overlap." Moreover, contrary to WorldCom's and MCI's assertion, local facilities may indeed be "redundant" even if they do not traverse

---

[12] MCI, http://www.mci.com/aboutus/products/local/localbiz/index.shtml; Brooks Fiber, www.brooks-fiber.com/site_3/locations.html; WorldCom, http://www.wcom.com/investor/investor/html. In addition to the 22 cities with facilities-based competition at this time, WorldCom competes on a non-facilities basis with MCI in Memphis, TN, and, according to the information on the companies' web sites, will soon be competing on a facilities basis in Washington, D.C., Dallas, Tx., Houston, Tx., and San Antonio, Tx.

[13] WorldCom and MCI Joint Reply, p. 16.

exactly the same streets. In addition, and perhaps most important, as a result of the merger, WorldCom and MCI will not construct new facilities that would be used to compete for business customers in the local exchange.

The economics of the merger, which are so pleasing to investors, are based on reductions in local exchange investment and reductions in sales expense. One important element in the successful expense reductions and cost cutting is the reduction in capital spending by MCI Metro and a scaling back of their investment plans. We reported this earlier in CWA Comments.[14] Merrill Lynch identifies these positive financial impacts of "Line Cost Savings MCI Metro" as $500 million in 1999 and growing to $1.2 billion in 2002.[15] (*See* Attachment.) These are the same numbers that we cited in our Comments based on documentation provided by MCI-WorldCom to the Securities Exchange Commission in their "8-K" filing on November 9th as Attachment 99.3. Subsequently MCI-WorldCom has dropped Attachment 99.3 in their amended S-4 filing. In the S-4, MCI-WorldCom identify the aggregate "synergy" savings, but do not break out the Local Savings. This amended dated Jan. 22, 1998 S-4 is the one that WorldCom and MCI attached to their January 26, 1998 Reply Comments.

We are not arguing here that as a result of the merger that there will be no investment, nor growth, nor that a larger competitor to the "Bells" will not be established. Our argument is simply that the merger will result in less investment in local service. MCI and WorldCom have

---

[14] CWA Comments, p. 23.

[15] Merrill Lynch and Company, "WorldCom Inc.," Feb. 1998.

not proven their claim that the "merger...would not eliminate significant sources of ... competition."

As Merrill Lynch notes in its February 4th positive analysis of the merger:

> **Reduced Intra-industry Competition:** Mergers with MCI and Brooks will reduce, on the margin, the level of intra-industry competition in both the US LD and local markets via the reduction in the number of major competitors.
>
> On the local side, completion of these two mergers would mean that MCI's Metro unit, Brooks, and WorldCom's MFS unit would no longer compete with each other. We therefore expect that local pricing will feel slightly less pressure and that significant overlapping expenditures (both capital and marketing) will be eliminated.[16]

As MCI and WorldCom have told Wall Street analysts, the "[merger] savings are anticipated to result from avoided capital costs."[17] This is a simple statement that there will be fewer facilities and less investment in local competition as a result of the merger.

---

[16] *Id.*, p. 2.

[17] MCI WorldCom Analyst Conference Call Merger Announcement, Nov. 10, 1997, p. 2. The source we used in CWA Comments was WorldCom, Inc. Form 8-K submitted to the Securities and Exchange Commission, Nov. 9, 1997, Exhibit 99.3, Analysts Presentation Given on Nov. 10, 1997 by MCI and WorldCom. A copy of the referenced document was entered into the public record in various state proceedings. In these reply comments, we use the following citation for the above referenced document: MCI WorldCom Analyst Conference Call Merger Announcement, Nov. 10, 1997 submitted as Appendix B, Objections and Responses of WorldCom, Inc. and MCI Communications Corporation to GTE's First Set of Interrogatories and Requests for Production of Documents, Pennsylvania Public Utility Commission, Docket Nos. A-312025F0002 and A-310236F004, Feb. 17, 1998, *Joint Application, as Amended, of WorldCom, Inc. and MCI Communications Corporation, MCI Telecommunications Corporation and MCI Metro Access Transmission Services Communications Corporation to WorldCom, Inc. by Merger, Through the Transfer of Stock* (hereinafter MCI and WorldCom Analysts Presentation).

MCI and WorldCom have offered no rebuttal to this analysis. In fact they embrace the financial benefits which will accrue to the corporation and articulate them in their discussions with analysts. However, financial success of a merger does not equate to public policy success. Investors are pleased when there is less competition, as profits increase. Regulators are disappointed when there is less competition as there is "less pressure" on "local pricing."

As a result of the reduced local facilities-based competition resulting from the merger, there will be a loss of consumer welfare as "local pricing will feel slightly less pressure."[18] Thus, the merger is not in the public interest to "promote competition...in order to secure lower prices and higher quality services for American telecommunications consumers."[19]

B. The Merged Entity Will Abandon MCI's Pre-Merger Plans to Compete in the Local Exchange to Serve Residential and Small Business Customers

Even more significant, as CWA noted in our Comments and Reply Comments, is the fact that as a result of the merger, MCI and WorldCom will abandon MCI's pre-merger plans to compete in the local exchange to serve residential and small business customers. Prior to the merger announcement, MCI had announced plans to invest $2 billion over the next few years in local facilities. But as a result of the merger, WorldCom and MCI have reported to shareholders and Wall Street that they will cut local service investments and sales expense in order to realize $5.3

---

[18] Merrill Lynch and Company, Inc., "WorldCom, Inc.," Feb. 1998, p. 2.

[19] Telecommunications Act of 1996, Pub. L. No. 104-104 (preamble), 100 Stat. 56 (1996) (hereinafter Telecommunications Act of 1996).

billion in "synergy" savings in the first four years after the merger.[20] As we noted in our Comments and Reply Comments, savings of this magnitude cannot be realized in four years simply through "merger-related efficiencies," but must reflect a shift in merger-related business strategy away from serving low-revenue, high-cost residential and small business customers.[21]

Dr. Dan Schiller emphasized these points in his report *Bad Deal Of the Century: The Worrisome Implications of the WorldCom-MCI Merger.* Dr. Schiller argues that "a WorldCom takeover of MCI will only intensify this strategic shift to service business and well-off residential subscribers..." Dr. Schiller speculates that MCI "will look seriously at selling its residential voice customers."[22]

WorldCom and MCI respond that "nothing could be further from the truth."[23] They argue that the merged entity will have the "financial incentive to fully load its local networks, including by carrying traffic of residential customers in off-peak hours."[24] However, MCI and WorldCom (through its MFS and Brooks Fiber subsidiaries) do not have local networks built out to the vast majority of residential customers. Thus, MCI's and WorldCom's claim that they have a financial

---

[20] CWA Comments, pp. 20-23.

[21] CWA Comments, pp. 16-24, and CWA Reply Comments, pp. 12-14.

[22] Dan Schiller, *Bad Deal of the Century, The Worrisome Implications of the WorldCom-MCI Merger,* Washington, D.C.: Economic Policy Institute, 1998.

[23] MCI and WorldCom Joint Reply, p. 19.

[24] *Id.*, p. 20.

incentive to fully load their network by serving residential customers in off-peak hours is irrelevant.[25]

Moreover, WorldCom and MCI fail to provide factual evidence to the Commission to dispute our analysis. In the Affidavit that the joint Applicants submitted to the Commission with their Reply Comments, Dennis W. Carlton and Hal S. Sider state that they have "not independently reviewed" WorldCom's and MCI's calculations of the synergy savings.[26] Even MCI's and WorldCom's own financial advisors state in their Opinion Letters to the WorldCom and MCI Boards that "they do not assume independent verification of such information"[27] and "relied on the financial forecasts of WorldCom provided by WorldCom management and modified with the approval of MCI management."[28]

MCI and WorldCom have also been unwilling to provide state Commissions reviewing the merger with evidence of plans to serve residential and small business customers. For example, in response to Data Requests submitted by the Montana Public Service Commission to WorldCom and MCI, the Applicants responded to a question regarding the source of merger-related synergies this way:

---

[25] Moreover, even where MCI or WorldCom facilities pass residential dwellings such as high-rise apartment buildings, MCI and WorldCom have not aggressively marketed local services to these customers.

[26] Declaration of Dennis W. Carlton and Hal S. Sider, Jan. 25, 1998, Attachment to WorldCom and MCI Joint Reply, p. 8.

[27] Opinion Letter of WorldCom's Financial Advisor, Amendment No. 3 to Form S-4, WorldCom, Inc., as filed with the Securities and Exchange Commission, Jan. 22, 1998, p. 45 (hereinafter Amended Form S-4).

[28] Opinion Letter of MCI's Financial Advisor, Amended Form S-4, p. 54.

> The aggregate savings or synergies of the merger are described in WorldCom's S-4/A that has been filed with the Securities and Exchange Commission. These aggregate values have not yet been and may not be developed on a state-specific level.[29]

In response to GTE's Data Requests in Montana, WorldCom and MCI noted that "the Applicants do not have documents discussing, analyzing, describing or relating to the benefits to be realized specifically in Montana as a result of the proposed merger."[30] When asked to provide a timeline of efficiencies, WorldCom and MCI responded that "the Applicants have not yet developed a specific timeline for Montana detailing the expected dates when efficiency savings will be achieved and the dates of implementation of all necessary upgrades, cutbacks, expenditures and other changes in order to achieve these efficiencies."[31]

In other states, the Applicants have refused to provide any documentation in response to similar Data Requests.

The failure to provide the FCC with specific date, plans, and studies regarding post-merger local exchange infrastructure and marketing plans is particularly problematic because WorldCom and MCI have taken the position before numerous state Commissions that state-level merger review is

---

[29] WorldCom, Inc. Response to Data Requests of Montana Public Service Commission: *In the Matter of the Application of WorldCom, Inc. for Approval to Transfer Control of MCI Communications Corp. to WorldCom, Inc.*, Docket No. D.97.10.191, March 18, 1998, p. 10.

[30] Responses of WorldCom, Inc. and MCI Communications Corporation to GTE's First Set of Data Requests, i*n the Matter of the Application of WorldCom, Inc. for Approval to Transfer Control of MCI Communications Corp. to WorldCom, Inc.*, Docket No. D.97.10.191, March 19, 1998, at GTE-3 (hereinafter Data Request Responses in Montana).

[31] *Id.*, at GTE-10.

unnecessary since the FCC is already reviewing the merger. The joint Applicants apparently argue for federal scrutiny when it provides cover to avoid scrutiny at the state level, and yet fail to provide documentation to enable the FCC to fulfill its obligations.

Rather than provide specific evidence of business and engineering plans, WorldCom and MCI substitute a vaguely worded letter from their chief executives Bernie Ebbers and Bert Roberts to Chairman Kennard. In this letter, they state their "intent" to compete for residential customers in the local exchange after the merger, but they emphasize, this "intent can be fulfilled only where real business opportunities exist."[32] Mr. Ebbers' and Mr. Roberts' letter of intent leaves the merged entity a wide loophole through which to drive their business strategy.[33] As we demonstrate below, it is unlikely that the merged entity will ever determine that "real business opportunities exist" in the local exchange residential and small business market. Rather, the merged entity will retain its "religious focus" on the mid- and large-sized business customer.[34]

---

[32] Letter dated January 26, 1998 to Honorable William Kennard from Bernard J. Ebbers and Bert C. Roberts, Jr., submitted as an attachment to the Public Service Commission of the State of New York in Reply Comments of WorldCom, Inc. and MCI Communications Corporation, *In re Petition of WorldCom, Inc. for Approval to Transfer Control of MCI Communications Corporation to WorldCom, Inc.*, Case 97-C-1804, Feb. 17, 1998.

[33] Indeed in their conference call to Wall Street Analysts, November 10, 1997, Bert Roberts reported, "Our message to the state and federal regulators is that we fully intend to offer competitive local service for all customers once the rules make that economically feasible...." MCI WorldCom Analyst Conference Call Merger Announcement, p. 4.

[34] WorldCom's CEO John Sidgmore attempted to back away from his Oct. 3, 1997 statement to the *Washington Post* that the merged company would "abandon" residential customers by explaining to the reporter that "our religious focus is on the business customer. It is a jihad." Mike Mills, "WorldCom Clarifies MCI Plans; Bidder Pledges It 'Will Not Abandon' Residential Customers," *Washington Post*, Oct. 4, 1997; CWA Comments, pp. 19-20.

Further evidence to support our view that the merged entity will not compete for residential and small business customers can be found by analyzing the balance sheets and income statements of WorldCom, MCI, and the pro-forma statements for the merged entity. As explained in the Affidavit submitted by David Shapiro (Appendix A), "the merger between MCI and WorldCom will create an entity that will be under extreme financial pressure...Such pressure may cause the new MCI-WorldCom to focus on the high-margin, high-growth segments of the industry at the expense of lower margin, lower growth segments."[35]

Mr. Shapiro analyzed the income statements and balance sheets of WorldCom, MCI, the pro-forma statements for the merged WorldCom/MCI, and compared them to the income statements and balance sheets of other major telecommunications competitors. Mr. Shapiro concluded that the balance sheet of WorldCom and of the merged WorldCom/MCI is "unlike any other telecommunications firm."[36]

Specifically, Mr. Shapiro found that pre-merger WorldCom and the merged WorldCom/MCI carry an extraordinary amount of what is called "goodwill and intangibles" as assets on their respective balance sheets.[37] According to standard accounting practice, "goodwill and intangibles" represent that portion of the difference between book value and the purchase price that cannot be attributed to the market value of specific assets. By textbook definition, goodwill

[35] Affidavit of David Shapiro, p. 6 (Appendix A to these Reply Comments).

[36] *Id.*, p. 2

[37] *Id.*

is an intangible asset of a business that represents future earnings greater than the average in the industry.[38]

As Mr. Shapiro explains, "goodwill and intangibles" represent 62.5 percent of WorldCom's total assets today. (Stated another way, fully two-thirds of WorldCom's assets derive from expectations of future earnings, and only one-third of WorldCom's assets are actual tangible goods or receivables.) According to Mr. Shapiro, the extreme levels of "goodwill and intangibles" represent the premium paid by WorldCom for past acquisitions.[39] In contrast, the industry average for "goodwill and intangibles" is only 11 percent of all assets. MCI is more in line with the industry average, at 9.6 percent. After the merger, the merged entity will closely resemble today's WorldCom, with "goodwill and intangibles" representing 61.6 percent of total assets.[40]

Furthermore, Mr. Shapiro notes that a new WorldCom-MCI will have a greater debt service stemming from its all cash payment to British Telecom for its 20 percent stake in MCI. This

---

[38] Kermit D. Larson and Barbara Chiappetta, *Fundamental Accounting Principles*, Fourteenth Edition, 1996, p. 429. To explain by example: Company A has assets worth $100 million but is purchased by Company B for $150 million. This is because Company B expects Company A to earn so much in the future that it is willing to pay more for its assets than they are worth today. Accountants would classify the $50 million difference between the purchase price and the book value of the assets as "goodwill and intangibles."

[39] Shapiro Affidavit, p. 3.

[40] *Id.*, pp. 2-4.

incremental debt burden will restrict cash flow that may have otherwise been spent on building telecommunications infrastructure.[41]

Mr. Shapiro explains the import of such a high "goodwill and intangibles" ratio and increased interest expense:

> [A] merger between MCI and WorldCom will create an entity that will be under extreme pressure to deliver on promised market share growth and cost reductions in order to offset the amortization of a very substantial amount of goodwill and intangibles and the incremental interest expense from transaction related borrows. Such pressure may cause the new MCI-WorldCom to focus on high margin, high growth segments of the industry at the expense of lower margin, lower growth segments.[42]

Finally, Mr. Shapiro explains, WorldCom has a price to earnings (P/E) ratio that is two to four times that of other major telecommunications companies. According to Mr. Shapiro, "a high P/E ration can only be sustained if WorldCom management succeeds in meeting investor expectations of earnings growth well above the telecommunications industry average."[43]

In sum, the merged entity will be under strong investor pressure to pursue a business strategy targeting high revenue, high-growth customers. In effect, this is what WorldCom and MCI have told investors. At the same time, they have signaled their "intent" to regulators that they will

---

[41] *Id.*,p. 5.

[42] *Id.*, p. 6.

[43] *Id.*

compete for lower-margin residential and small business customers "where business opportunities exist." As one Wall Street analyst noted,

> This is a classic case of a company's telling Wall Street one thing and Washington something else. Shareholders think that they [WorldCom/MCI] won't spend a lot of money on the residential market, and Washington expects them to do just that.[44]

The Commission must decide whether to believe what WorldCom and MCI tell them or whether to believe what WorldCom and MCI tell Wall Street. WorldCom and MCI bear the burden of proof of documenting their plans to compete in the local exchange residential and small business market. Without that documentation, WorldCom and MCI fail to meet the merger review standard of the Bell Atlantic/NYNEX Order, and have failed to show that the merger will "enhance competition" in the local market.

III. The Merger Would Create a Dominant Carrier with 63 Percent of the Internet Backbone Market

Similarly, the Applicants fail to demonstrate that the merger will not harm competition in the Internet backbone market. The Applicants fail to provide the Commission with the data necessary to conduct a thorough merger analysis, including data on Internet market structure, the number and size of significant market participants, traffic flow, interconnection agreements, peering policies, numbering policies, and other potential market entry barriers.

---

[44] Scott Cleland, Legg Mason Precursor Group, *quoted in* Seth Schiesel, "*Two Corporate Cultures Meet in MCI-WorldCom Merger*," *The New York Times,* March 11, 1998, pp. B1 and B20.

In his study of the WorldCom-MCI merger, Dr. Jeffrey Keefe noted that WorldCom and MCI have failed to provide the Commission with the data necessary to prove their case. Dr. Keefe found that "neither WorldCom nor MCI have provided adequate data to refute the claim that the Internet Backbone Provider market is separate from the Internet access market. They have also not provided basic information on their Internet revenues, their Internet market share, and their central role in providing Internet connectivity (emphasis in original).[45] Dr. Keefe added that that this failure to provide data "is further complicated in this case by a commercial culture of secrecy" that pervades the Internet marketplace.[46]

The paucity of publicly available data on the Internet market makes it imperative that the Commission request the Hart-Scott-Rodino documents from the U.S. Department of Justice (DOJ) to use in its own merger review and that the Commission make this information available to commentators under protective order.

Below we use publicly available data to summarize the evidence to show that the merger will result in one firm with dominant control over the Internet backbone market and that this dominant firm would have the market power, through unilateral or concerted action, to set the price and terms for interconnection to the Internet.

---

[45] Jeff Keefe, *Monopoly.com: Will the WorldCom-MCI Merger Tangle the Web?* (uncorrected proofs), Washington, D.C.: Economic Policy Institute, 1998, p. 3.

[46] *Id.*, p. 4.

A. The Internet Backbone Is a Relevant Product Market.

The Commission defines a product market as "a service or group of services for which there is no close demand substitute."[47] WorldCom and MCI vigorously deny that there is a separate Internet backbone market. However, virtually all independent researchers discuss a distinct Internet backbone market as a service for which there is no close demand substitute. We summarize these market descriptions below.

- Kevin Werbach, FCC Office of Plans and Policy, *Digital Tornado:* Internet Service Providers (ISPs) "connect end users to Internet backbone networks" and backbone providers "such as MCI, UUNet, and Sprint (that) route traffic between ISPs and interconnect with other backbone providers."[48]

- Jack Rickard, *Boardwatch Directory of Internet Service Providers:* Internet Service Providers provide connectivity between end users (customers) to the Internet backbone and Internet backbone providers. A national Internet backbone provider is a "company that has physically located a high-speed TCP/IP router in a number of cities, and then leased high-speed data lines from long distance exchange carriers to link the routers--thus forming a national "backbone" connecting those cities."[49]

- Drs. Jeffrey MacKie-Mason and Hal R. Varian, *Economic FAQs About the Internet*: "The U.S. portion of the Internet is best thought of as having three levels. At the bottom are Local Area Networks (LANs). Usually the local networks are connected to a regional or mid-level network. The mid-level networks connect to one or more backbones. A

---

[47] Bell Atlantic NYNEX Order, 50.

[48] Kevin Werbach, *Digital Tornado: The Internet and Telecommunications Policy,* Washington, D.C.: Office of Plans and Policy, Federal Communications Commission, March 1997, 12.

[49] Jack Rickard, "Introduction to the Fall 1997 Boardwatch Directory of Internet Service Providers," *Internet Service Providers,* all 1997, p. 14.

backbone is an overarching network to which multiple regional networks connect, and which generally does not servie directly any local networks or end-users."[50]

- Dr. Jeffrey Keefe, *Monopoly.com*
  "End users most often gain access...through individual connections with an Internet Service Provider or through computer networks in organizations such as universities and businesses, which may directly connect to Internet Backbone Providers using dedicated lines.[51]

- Maloff Group International, *1996-1997 Internet Access Providers Marketplace Analysis:*
  This report distinguishes between the Internet Backbone Provider and the ISP market; the authors define backbone providers as "those organizations that have established their own multiple node networks in more than one geographic area, specialize in commercial services, and are not reliant solely on another Internet Access Provider for nationwide transport or connectivity."[52]

- Frost and Sullivan, *U.S. Internet Service Markets:*
  "ISPs generally fall into three basic categories: backbone, regional, and local. A backbone ISP maintains and operates its own nationwide network. Backbone ISPs typically lease major trunk lines from the major telecommunications interexchange carriers...Backbone ISPs also operate and maintain network operation centers so they can monitor traffic flow and network integrity, and troubleshoot problems...Local ISPs typically lease a T1 or T3 communication line from a backbone or regional ISP. Local ISPs provide dial-up Serial Line IP (SLIP) or Point-to-Point (PPP) Protocol service to provide hot-to-network connections.[53]

- European Commission
  "The Commission decided to carry out a second-phase inquiry given that, on the basis of information obtained in investigations carried out to date, it is concerned about the parties' combined market share in relation to the supply of Internet backbone services. Services affected by the merger are the provision of a network of high capacity, long distance

---

[50] Jeffrey K. Mackie-Mason and Hal R. Varian, "Economic FAQs About the Internet," in Lee W. McKnight and Joseph P. Baily, *Internet Economics,* Cambridge: MIT Press, 1997, p. 30.

[51] Keefe, p. 5.

[52] Joel Maloff and Rick R. Smith, *1996-7 Internet Access Providers Marketplace Analysis,* Dexter, Mi.: Maloff Group International, Oct. 1997, p. 20.

[53] Frost and Sullivan, "U.S. Internet Service Markets," 1996, p. 2-10.

connections capable of carrying data nationally and internationally, and interconnected with other networks of similar scale through peering arrangements."[54]

B. The Merged Entity Would Control More than 63 Percent of the Internet Backbone Market

The next step in a merger analysis is to identify the major market participants.

In the four years since privatization of the NSFNet Internet backbone, the commercial Internet backbone market has consolidated into four or five large backbone networks that dominate the market. Researchers and the industry trade press typically refer to these firms as Tier One backbone providers. In a 1997 study of Internet interconnection, Richard Cawley of the European Commission wrote that "half a dozen or more ISPs provide the bulk of backbone service in the United States over capacity that is owned by the three or four main long-distance infrastructure operators."[55] Industry engineers reporting in *The Cook Report on the Internet* distinguish between "the top five providers" (MCI, WorldCom's UUNet, Sprint, WorldCom's ANS, and GTE Internetworking) and the "second tier national providers."[56] As the publicly available market share data makes clear (*see* below), there is a wide gap in market share between

---

[54] "European Commission to Carry Out Detailed Inquiry into Proposed merger Between WorldCom and MCI," Press Release, March 4, 1998.

[55] Richard Cawley, "Interconnection, Pricing, and Settlements: Some Healthy Jostling in the Growth of the Internet," in Brian Kahin and James H. Keller, *Coordinating the Internet*, Cambridge: MIT Press, 1997, p. 366.

[56] Sean Doran, "Tier One vs Tier N Providers," *The Cook Report on the Internet,* Jan. 18, 1997 Letter to the Editor that appeared in the March 1997 edition.

the three largest Tier One backbone providers (MCI, WorldComm's UUNet, and Sprint) and the other Two Tier one providers.[57]

In addition to the Tier One backbone providers, *Boardwatch* magazine identifies 32 second-tier backbone providers[58], only a handful of which have no more than one percent market share.[59]

Using publicly available data, CWA and other commentators demonstrate that a merged WorldCom and MCI would control upwards of 63 percent of the Internet backbone market. WorldCom and MCI vigorously deny that they will have this market share. Instead, they argue that the merged entity would only control roughly 20 percent of Internet revenues.

In his report on the WorldCom-MCI merger, Dr. Keefe critiques the WorldCom and MCI market share figure. He notes that WorldCom and MCI base their revenue figure on total Internet-related revenues, including on-line services, advertising, host-based services, dial-up access, dedicated access, transport and other sources of Internet-related revenues.[60] According to Dr. Keefe, total

---

[57] Moreover, MCI, WorldCom's UUNet, and Sprint have further market advantages because they carry data traffic primarily over their own long-distance networks.

[58] *Boardwatch,* p. 6 (for number of backbone providers).

[59] Internet Affidavit of Robert G. Harris on Behalf of GTE, CC Docket No 97-211, March 13, 1998, 19.

[60] Keefe adds that it is impossible to verify the accuracy of the WorldCom and MCI figures, since they do not provide any detail on how they arrive at this figure. Using the flawed Frost and Sullivan figures, Dr. Keefe re-calculates the WorldCom/MCI total Internet industry revenue figure based on publicly available sources (SEC filings, *Boardwatch Magazine* and MCI Internet Vision Statement) to arrive at an Internet revenue estimate for a combined WorldCom and MCI of at least $1.5 billion, which yields a lower bound market share estimate of 32%, using their (WorldCom/MCI's) methodology of doubling Frost and Sullivan 1996 Internet revenue figure as the base. However, Dr. Keefe emphasizes that the reliability of both of these estimates is open to dispute. (Keefe, p. 13).

Internet-related revenue does not provide the Commission with the information it needs to evaluate the number of major participants and their market share in the Internet backbone market.

Dr. Keefe further argues that a more accurate calculation of Internet backbone market share using publicly available data can be derived by relying on two sources: a marketplace analysis of Internet access providers by the Maloff Group and the *Boardwatch* survey of Internet Service Provider (ISP) backbone connections.[61] We summarize Dr. Keefe's market share analysis below.

First, Dr. Keefe calculates market share for the merged entity using the Maloff Report data, which bases market share on the share of industry revenue generated by Internet service providers that would connect through WorldCom-MCI. Using this data, Dr. Keefe calculates a market share of 68.3 percent for the merged entity, which includes revenues from MCI and WorldCom backbone networks (ANS, CNS, and UUNet), as well as from AOL that has a long-term arrangement for network services from WorldCom, and from Microsoft Network and Earthlink, two other large Internet providers that obtain their Internet connectivity from WorldCom's UUNet. Dr. Keefe notes that arguably one should also add the revenues of Concentric, the seventh largest Internet provider which currently obtains its Internet backbone connectivity from both MCI and WorldCom. According to Dr. Keefe, adding Concentric revenue brings the

[61] Keefe, pp. 14-19. *See also* Maloff Group International, Inc., *1996-1997 Internet Access Providers Marketplace Analysis*, Oct. 1997 and Boardwatch, *Internet Service Providers,* Fall 1997 and Jack Rickard, "The Big, The Confused, and the Nassty: UUNet Residgns from the Internet--US West Expresses Clueless Greed and Confusion, the FCC Rules on Access Charges," *Boardwatch*, June 1997 (http://www.boardwatch.com/mag/97/June/bwm1.htm).

combined market share estimate for revenues generated by Internet Service Providers connected to the merged entity's backbone to 71.5 percent.[62]

Dr. Keefe also notes that the *Boardwatch* data which provides the number of ISPs connected to each backbone and the number of connections that each ISP has with each backbone is another useful measure of Internet backbone market share. The major advantage of these measures, he notes, is that "*Boardwatch* did the counting and performed the calculations, not MCI, WorldCom, or their critics."[63] Thus, the market share data can be independently verified. In our Reply Comments, we noted that evaluating market share using ISP connection data is a relevant starting point for merger analysis because the key issue in evaluating Internet dominance relates to the issue of interconnection.[64]

Dr. Keefe summarizes the *Boardwatch* data from their June 1997 and Fall 1997 surveys. The merged entity would have 68 percent of ISPs connecting to its backbones (June 1997 data), and somewhere between 55 percent (June 1997) or 48 percent (Fall 1997) of total ISP connections.[65]

To be sure, neither of these market share measures is perfect. According to press reports, the U.S. Department of Justice has requested traffic flow data for the first week of March 1998 and

---

[62] *Id.*, pp. 16-17.

[63] *Id.*, p. 16.

[64] CWA Reply Comments, p. 8.

[65] *Id.*, pp. 14-15.

other information such as interconnection agreements from the major backbone carriers to assist the Department in evaluating backbone market share.[66] The Commission must have access to this information in order to evaluate the impact of the merger on the Internet backbone market. As already noted, the Commission should request the Hart-Scott-Rodino documents from the DOJ.

C. The Merged Entity Will Be Able to Use its Dominance over the Internet Backbone Market to Engage in Anti-Competitive Behavior

1. The Merged Entity Would Have the Market Power to Set the Terms and Price of Interconnection

CWA and other commentators have argued that should any one entity dominate the Internet backbone market, that entity would be able, through unilateral or concerted action, to set the terms and price of interconnection to the Internet. This would slow the growth of the Internet and raise the cost of Internet access to consumers.

WorldCom and MCI reply that Internet entry barriers are low, and, furthermore, three large new carriers will soon enter the market, significantly increasing competition in the Internet marketplace.

WorldCom and MCI, however, sidestep and thus avoid the essential point that CWA and other commentators stress--that the merged entity will be able to exercise monopoly power through its

[66] John R. Wilke and Jared Sandberg, "WorldCom, MCI Probe is Widened," *The Wall Street Journal,* March 10, 1998, A-3 and A-8.